

Message Text

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PAGE 01 MANILA 12841 01 OF 02 291114Z

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ACTION TRSE-00

INFO OCT-01 EA-06 ISO-00 NEA-06 IO-04 AID-05 CIAE-00

COME-00 EB-04 FRB-01 INR-05 NSAE-00 RSC-01 XMB-02

OPIC-03 SP-02 CIEP-01 LAB-01 SIL-01 OMB-01 NSC-05

SS-15 STR-01 CEA-01 L-01 H-01 PA-01 USIA-06 PRS-01

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P 290826Z OCT 74

FM AMEMBASSY MANILA

TO SECSTATE WASHDC PRIORITY 7975

LIMITED OFFICIAL USE SECTION 1 OF 2 MANILA 12841

USADB

FOR NAC AGENCIES

E.O. 11652: ADS DECLASS 1/31/75

TAGS: EAID, EFIN, RP

SUBJECT: PROPOSED ADB TECHNICAL ASSISTANCE LOAN - THIRD MINDANAO
POWER PROJECT (PHILIPPINES)

SUMMARY: ADB MANAGEMENT PROPOSES \$1.0 MILLION
EQUIVALENT LOAN FROM ORDINARY CAPITAL RESOURCES TO
PHILIPPINES TO FINANCE FOREX COST OF ENGINEERING
SERVICES FOR POSSIBLE 225 MW AGUS III HYDROPOWER
STATION. PROJECT IS CONSIDERED TO BE NEXT LOGICAL
STEP IN DEVELOPMENT OF HYDROPOWER POTENTIAL OF AGUS
RIVER IN MINDANAO. USADB RECOMMENDS FAVORABLE NAC
ACTION. END SUMMARY.

1. ADB DOC R97-74 WITH ATTACHMENTS DESCRIBING PROPOSED
LOAN POUCHED ADDRESSEES OCT. 22. BOARD CONSIDERATION
SCHEDULED NOV. 7.

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PAGE 02 MANILA 12841 01 OF 02 291114Z

2. ADB MANAGEMENT PROPOSING \$1.0 MILLION TECHNICAL ASSISTANCE (TA) LOAN FROM ORDINARY CAPITAL RESOURCES TO PHILIPPINES. PROCEEDS WILL FINANCE FOREX COST OF ENGINEERING SERVICES OF AGUS III HYDROPOWER STATION IN MINDANAO, INCLUDING PREPARATION OF DETAILED DESIGNS, COST ESTIMATES AND TENDER DOCUMENTS. PROPOSED TERMS ARE 10 YEAR AMORTIZATION INCLUDING TWO YEAR GRACE PERIOD, 8 1/4 PERCENT INTEREST. NATIONAL POWER CORPORATION (NPC) TO BE BORROWER AND EXECUTING AGENCY, AND REPUBLIC OF PHILIPPINES THE GUARANTOR.

3. MINDANAO REGION (INCLUDING SULU ARCHIPELAGO) CONSTITUTES ABOUT ONE-THIRD OF COUNTRY'S TOTAL LAND AREA AND CONTAINS ABOUT 22 PERCENT OF POPULATION. WHILE ECONOMY IS PREDOMINANTLY AGRICULTURAL, THERE ARE PROSPECTS FOR SIGNIFICANT EXPANSION IN MANUFACTURING AND MINING. HOWEVER, EXTREMELY POOR STATE OF INFRASTRUCTURE, PARTICULARLY TRANSPORT AND POWER SUPPLY, IS MAJOR OBSTACLE IN DEVELOPING AREA'S RICH RESOURCES. BANK HAS BEEN PLAYING ACTIVE ROLE IN MINDANAO'S OVERALL ECONOMIC DEVELOPMENT THROUGH PROVISION OF FINANCIAL AND TECHNICAL ASSISTANCE IN AGRICULTURE AND INFRASTRUCTURE. TOTAL COMMITMENTS TO DATE (EXCLUDING DEVELOPMENT BANK SUBLOANS) AMOUNT TO \$90.2 MILLION.

4. LONG-RANGE POWER DEVELOPMENT PROGRAM IN MANDANAO CALLS FOR DEVELOPMENT OF SERIES OF HYDROPOWER SITES ON AGUS RIVER TO ACCOMMODATE AREA'S PROJECTED LOAD GROWTH. BANK IS PRESENTLY INVOLVED IN MINDANAO'S POWER SECTOR DEVELOPMENT AS RESULT OF LOANS FOR FIRST (\$23.4 MILLION) AND SECOND (\$21 MILLION) MINDANAO POWER PROJECTS IN NOV. 1971 AND JULY 1972, RESPECTIVELY. OVERALL POWER DEMAND DROWTH RATE FOR MINDANAO GRID IS PROJECTED AT 11.2 PERCENT FOR FY 1978-1983 PERIOD.

5. PROJECT ENVISAGES PLANT OF 225 MW (3 X 75 MW) INSTALLED CAPACITY. TECHNICAL FEASIBILITY STUDY CONDUCTED BY NPC IN MARCH 1974 ESTIMATES TOTAL COST OF PLANT AT \$79 MILLION INCLUDING \$34 MILLION FOREX COMPONENT BUT INCLUDING INTEREST DURING CONSTRUCTION. NPC PLANS TO APPROACH BANK LIMITED OFFICIAL USE

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PAGE 03 MANILA 12841 01 OF 02 291114Z

FOR LOAN SUBSEQUENTLY FOR CONSTRUCTION HASE OF PROJECT, AT WHICH TIME TA LOAN MAY BE CONSOLIDATED WITH CONSTRUCTION LOAN OF APPROVED BY BANK.

6. PROPOSED TA LOAN WILL COVER \$1.0 MILLION FOREX COST OF CONSULTANT SERVICES. (PROVISION IS MADE FOR 15 PERCENT CONTINGENCY IN VIEW RECENT SHARP INCREASE IN CONSULTANT FEES.) TOTAL COST OF TA IS ESTIMATED AT \$1.29 MILLION,

WITH NPC PROVIDING LOCAL CURRENCY REQUIREMENTS. CONSULTANTS, TO BE ENGAGED BY NPC IN ACCORDANCE WITH BANK'S GUIDELINES ON USES OF CONSULTANTS, WILL (A) REVIEW EXISTING FEASIBILITY STUDIES AND FURTHER STUDY ON AGUS III HYDROPOWER DEVELOPMENT CONDUCTED LAST MARCH BY NPC; (B) PREPARE DETAILED DESIGN FOR CONSTRUCTION OF HYDROPOWER STATION; AND (C) PREPARE COMPLETE TENDER DOCUMENTS. CONSULTANTS ARE EXPECTED TO UTILIZE LOCAL EXPERTISE TO FULLEST EXTENT POSSIBLE BY ASSOCIATING WITH LOCAL CONSULTING FIRMS.

7. NPC IS GOVT-OWNED CORPORATION ENGAGED IN GENERATION, TRANSMISSION AND WHOLESALE SUPPLY OF POWER TO UTILITIES AND MAJOR PHILIPPINE INDUSTRIAL USERS. IT HAS IMPLEMENTATION RESPONSIBILITY FOR BOTH PROJECTS (PARA 4 ABOVE) FOR WHICH BANK IS CURRENTLY PROVIDING FINANCING. IN FINANCIAL COVENANTS UNDER SECOND MINDANAO POWER PROJECT, NPC HAD AGREED TO ACHIEVE 8 PERCENT RATE OF RETURN ON NPC'S OVERALL NET REVALUED ASSETS BY JULY 1, 1974 AND TO REDUCE ACCOUNTS RECEIVABLE TO LEVEL OF NO MORE THAN 25 PERCENT OF ANNUAL GROSS REVENUE. HOWEVER, ANNUAL TARIFF INCREASES TO DATE HAVE INCREASED RATE OF RETURN FROM 4.6 PERCENT IN 1971 TO JUST 5.5 PERCENT IN 1974. SHORTFALL IN PART, DUE TO UNEXPECTED NEED FOR BULK PURCHASES OF HIGH COST POWER FROM MANILA ELECTRIC COMPANY, A PRIVATE UTILITY WHICH SELLS BULK POWER FOR RESALE, TO SUPPLEMENT REDUCED POWER GENERATION FROM HYDRO PLANTS DUE TO LAST YEAR'S DROUGHT. ALSO, ACCOUNTS RECEIVABLE HAVE CONSISTENTLY EXCEEDED REQUIRED LEVEL DUE TO FINANCIAL DIFFICULTIES OF SOME IMPORTANT CONSUMERS, AMOUNTING TO ABOUT 50 PERCENT OF SALES REVENUE AT END OF FY 1974. DESPITE THESE SHORTCOMINGS, NPC'S PRESENT OVERALL FINANCIAL CONDITION APPEARS GENERALLY ACCEPTABLE.

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PAGE 01 MANILA 12841 02 OF 02 291011Z

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INFO OCT-01 EA-06 ISO-00 NEA-06 IO-04 AID-05 CIAE-00

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LIMITED OFFICIAL USE SECTION 2 OF 2 MANILA 12841

8. TO ENSURE FUTURE FINANCIAL SOUNDNESS AND ACHIEVE 8 PERCENT RATE OF RETURN, NPC HAS AGREED TO UNDERTAKE ANNUAL TARIFF REVIEW DURING FIRST THREE MONTHS OF EACH FISCAL YEAR; TO MAINTAIN SUITABLE FUEL ADJUSTMENT CLAUSE IN RATE STRUCTURE; AND TO REDUCE ACCOUNTS RECEIVABLE TO NOT MORE THAN 25 PERCENT OF TOTAL ANNUAL GROSS REVENUE BY END 1976. PROJECTION OF CONSOLIDATED EARNINGS AND CASH FLOW FIGURES SEEM REASONABLE, AND OVERALL PRO FORMA FINANCIAL POSITION APPEARS REALISTIC. FURTHERMORE, TO IMPROVE FINANCIAL ASPECTS OF MINDANAO OPERATION, NPC HAS ALSO AGREED TO IMPLEMENT SUBSTANTIAL UPWARD ADJUSTMENT OF MINDANAO TARIFFS WITHIN NEXT THREE YEARS PRIOR TO COMMISSIONING OF MINDANAO GRID AND TO PREPARE TEN-YEAR FINANCIAL PLAN FOR MINDANAO GRID PRIOR TO END 1974. (SEE SCHEDULE 4 OF LOAN AGREEMENT.)

9. CONSULTANTS ENGAGED FOR BANK-ASSISTED SECOND MINDANAO POWER PROJECT RECOMMENDED IMMEDIATE COMMENCEMENT OF AGUS III HYDROPOWER DEVELOPMENT TO ACCOMMODATE RAPID BUILD-UP OF LOAD IN MINDANAO REGION. PROPOSED TA WILL HELP
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PAGE 02 MANILA 12841 02 OF 02 291011Z

REMOVE POSSIBLE TECHNICAL DIFFICULTIES, FACILITATE PREPARATION OF DETAILED CONSTRUCTION DESIGN, AND ESTABLISH RELIABLE COST ESTIMATES WHICH SHOULD AVOID POSSIBLE COST OVERRUNS. (FYI: FIRST BANK-ASSISTED MINDANAO POWER PROJECT IS EXPECTED TO EXPERIENCE \$18.4 MILLION FOREX COST OVERRUN. SECOND MINDANAO POWER PROJECT IS PRESENTLY ANTICIPATED TO RESULT IN ABOUT 60 PERCENT FOREX COST OVERRUN.) AS TA WILL INCLUDE PREPARATION OF SPECIFICATIONS AND TENDER DOCUMENTS SUITABLE FOR INTERNATIONAL BIDDING, IMPLEMENTATION OF PROPOSED AGUS III HYDROPOWER DEVELOPMENT WILL BE EXPEDITED.

10. NPC'S LONG-RANGE POWER DEVELOPMENT PROGRAM IN MINDANAO CALLS FOR SUCCESSIVE DEVELOPMENT OF SERIES OF HYDROPOWER SITES ON AGUS RIVER TO ACCOMMODATE PROJECTED LOAD GROWTH. NPC AND CONSULTANTS HAVE ESTABLISHED TECHNICAL AND ECONOMIC FEASIBILITY FOR AGUS III, AND BANK MISSION HAS CONFIRMED

THAT IT IS MOST APPROPRIATE ECONOMIC SOLUTION TO
MEET MINDANAO'S NEAR TERM POWER DEMAND. USADB SUPPORTS
PROPOSAL AND RECOMMENDS FAVORABLE NAC ACTION. NEVERTHE-
LESS, USADB CONCERNED THAT NPC HAS NOT MET PAST FINANCIAL
COVENANTS (PARA 7 ABOVE). CONSEQUENTLY, TEND TO VIEW
CURRENT ASSURANCES PARA 8 WITH RESERVATIONS AND INTEND
TO PURSUE MATTER WITH BANK.

11. US MISSION MANILA COMMENTS FOR NAC GENCIES WILL BE
PROVIDED SEPTEL, PURSUANT TO STATE 119795 DTD 3 JULY 1972.

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Message Attributes

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